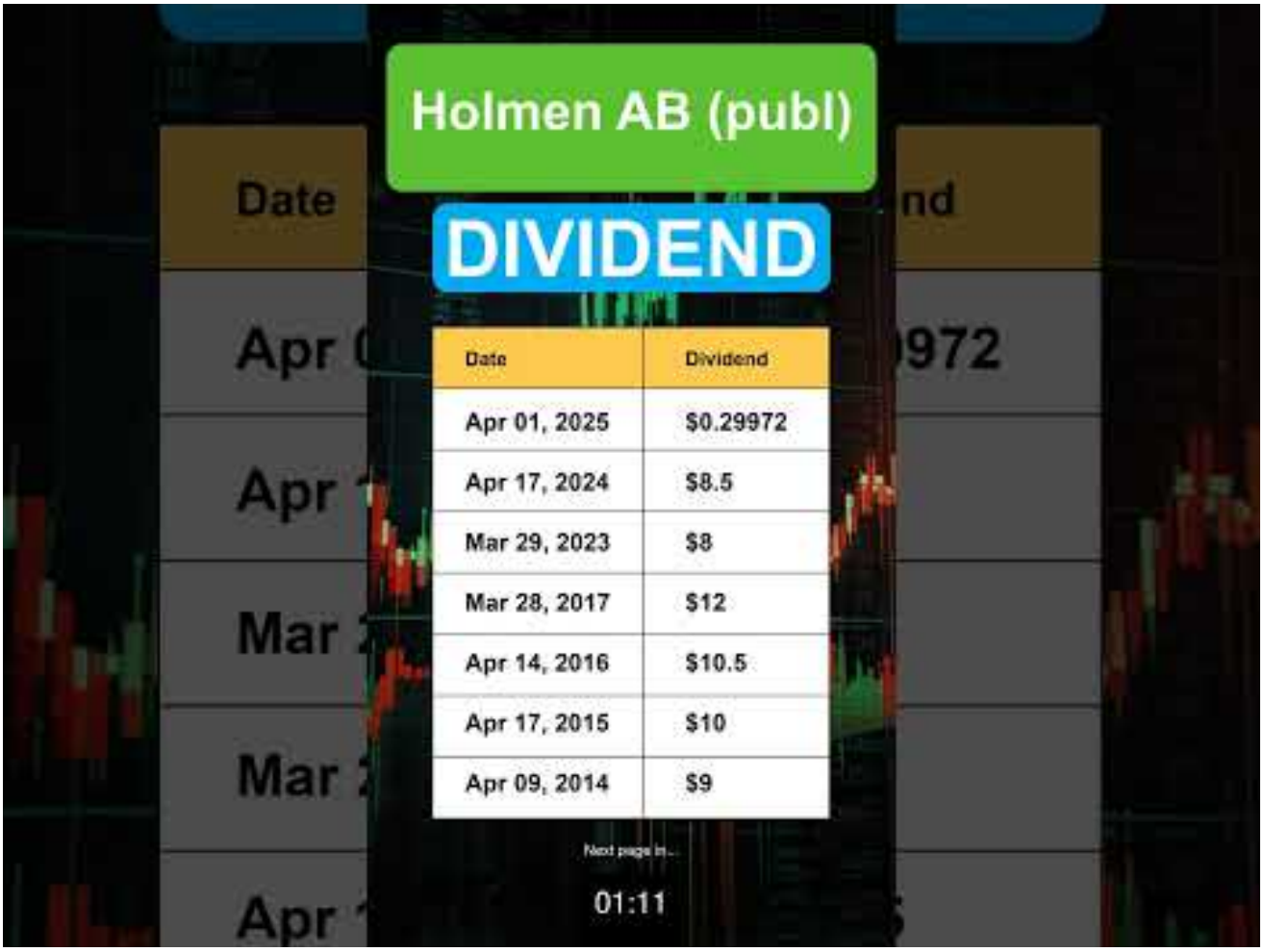
What to check in an ETF before adding it to your portfolio

Start with the big picture: why that ETF exists

Every exchange-traded fund is built around a strategy. Some track a broad market index, others target a sector, a theme, or a factor like value or momentum. Before looking at any numbers, ask yourself what the fund is designed to do and whether that design fits the role you need it to play. A clean-energy ETF and a short-term Treasury ETF may both trade on the same exchange, but they serve completely different purposes. If you are building a diversified portfolio, you want each holding to earn its place, not just fill a slot.

Expense ratio: what you pay every year

The expense ratio is the annual fee the fund charges as a percentage of assets. It comes out of returns whether the market goes up or down. Over time, even a few basis points of difference can compound into a meaningful gap in total return. Compare the expense ratio of any ETF you are considering with the category average. A fund that charges significantly more should offer a clear reason, such as active management or exposure to a niche market that is hard to access otherwise. For most core holdings, low-cost index-based ETFs are the default choice.



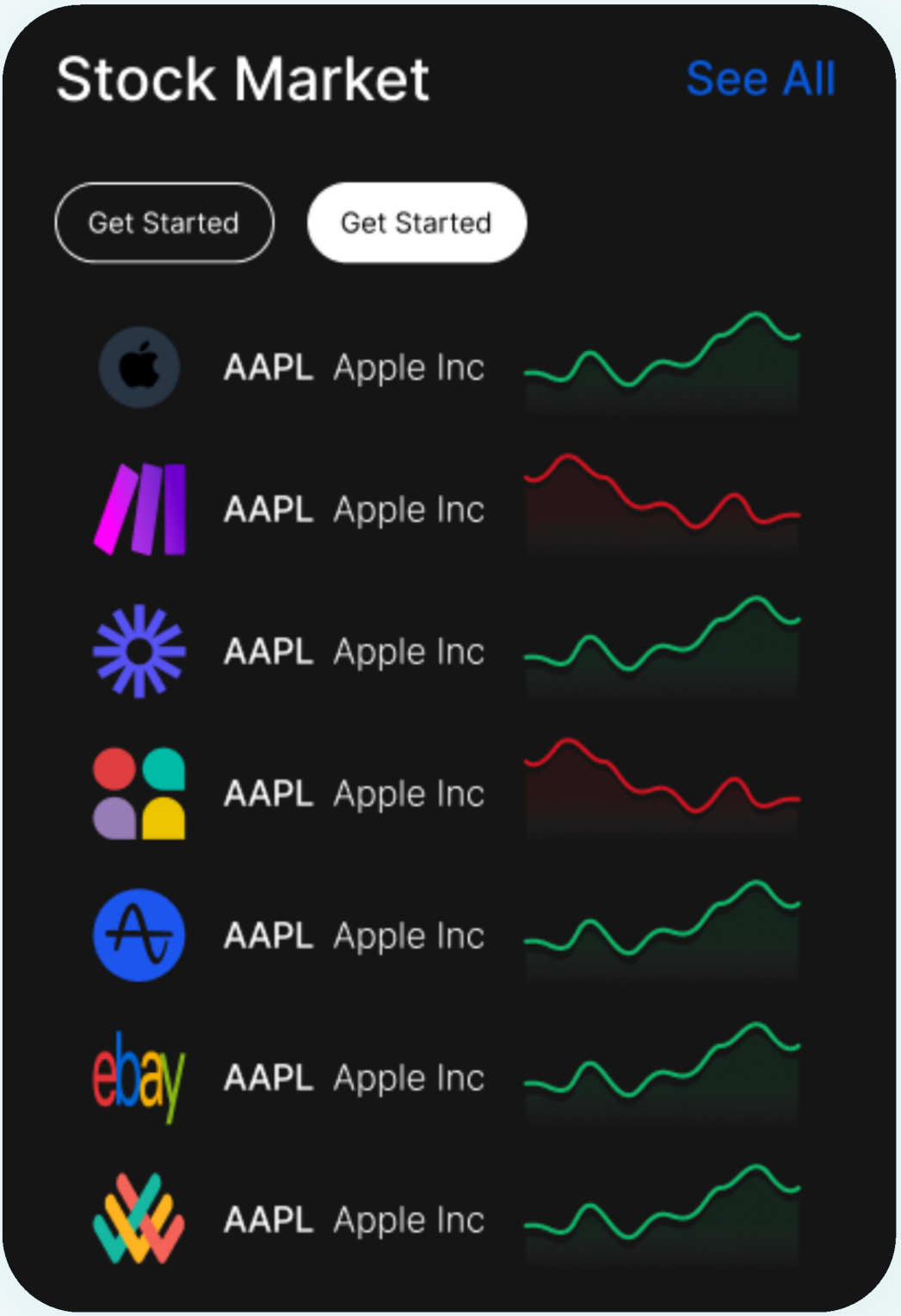
Tracking error: how closely the fund follows its index

An ETF that claims to track the S&P 500 should move in line with that index. Tracking error measures the difference between the fund's return and the index return over a given period. A small tracking error is normal, especially for funds that use sampling rather than holding every security. A large tracking error may signal structural issues, such as inefficient sampling, high costs, or illiquid underlying assets. Check the fund's tracking difference over one, three, and five years. Consistency matters more than a single year of close tracking.

Fund holdings: what you actually own

The name on the tin does not always match what is inside. Some sector ETFs hold stocks that are only loosely related to the sector label. Some dividend-focused funds tilt heavily toward financials and utilities, which changes the risk profile. Review the top ten holdings and the overall composition of the fund. You want to know whether the ETF gives you the exposure you expect or whether it layers on extra risk you did not plan for. This is where the tools for comparing ETF holdings become useful. They let you see overlap between funds, check concentration in a single stock, and verify that the fund's actual holdings align with its stated

objective. A quick overlap check can reveal that two supposedly different ETFs share most of their top positions, which defeats the purpose of diversification.



Sector allocation and asset allocation

Even an ETF that calls itself diversified may be heavily weighted in one sector. A broad US equity ETF, for instance, may have a large allocation to technology stocks because the index it tracks is market-cap weighted. That is fine if you know about it and you balance it elsewhere. The problem arises when you combine several sector funds and end up with a portfolio that is far more concentrated than you realise. Check the sector breakdown of each ETF and compare it with your overall target allocation. The same logic applies to asset allocation if you mix equity, bond, and commodity ETFs. The goal is intentional exposure, not accidental overlap.

Portfolio turnover: how much the fund trades

Portfolio turnover measures how often the fund buys and sells its holdings in a year. A high turnover rate can mean higher transaction costs, which are not always visible in the expense ratio. It can also indicate that the fund manager makes frequent adjustments, which may or may not add value. For index funds, turnover tends to be low because the index changes infrequently. For actively managed or thematic ETFs, turnover can be much higher. Look at the turnover ratio and consider whether the strategy justifies the extra trading. High turnover also tends to generate more short-term capital gains, which can create a tax drag in taxable accounts.

Bid-ask spread: the cost of trading

When you buy or sell an ETF, the price you get is not the net asset value (NAV) but the market price, which depends on supply and demand. The bid-ask spread is the difference between the highest price a buyer will pay and the lowest price a seller will accept. A narrow spread means you can trade cheaply; a wide spread eats into your returns, especially if you trade frequently. Spreads are generally tight for large, liquid ETFs and wider for niche or low-volume funds. Check the average spread during normal trading hours. If you plan to hold the ETF for years, a slightly wider spread matters less, but for a short-term position it can be a real cost.



Net asset value and premium/discount history

The net asset value of an ETF is the per-share value of its underlying holdings. The market price can trade above or below the NAV. A persistent premium means you are paying more than the assets are worth; a persistent discount means you can buy at a bargain, though that may reflect underlying problems. Most large ETFs trade close to NAV most of the time, but some, especially those holding illiquid assets or foreign securities, can deviate significantly. Review the fund's premium/discount history, particularly during volatile periods. A fund that routinely trades at a wide premium is less attractive because you are overpaying for the exposure.

Putting it together: a practical sequence

You do not need to run every check on every ETF every time. Build a routine that starts with the expense ratio and tracking error, then moves to holdings and sector allocation. If those pass, check turnover and trading costs. The **tools for comparing ETF holdings** can help you scan multiple funds at once, so you can spot concentration issues and fee differences before you commit. Use them to compare candidates side by side, especially when you are choosing between two ETFs that target the same market segment. A quick side-by-side view often reveals that the cheaper fund also has a tighter spread and lower turnover, making it the better long-term choice.

Watch for hidden risks

Some risks do not show up in the standard metrics. An ETF that uses derivatives or leverage can behave very differently from its index. A commodity ETF that rolls futures contracts can lose value even if the spot price stays flat, thanks to contango. A bond ETF with a long duration will fall more when interest rates rise. Read the prospectus and understand the fund's structure before you buy. No single number tells the full story. The checklist gives you a framework, but judgment still matters. If something feels off, skip that ETF and look for another that aligns better with your goals.



Keep the portfolio in view

Each ETF you add changes the overall mix. After you select a few funds, run a combined holdings report to see your total exposure to individual stocks, sectors, and asset classes. A portfolio of five well-chosen ETFs can still be unbalanced if they all lean toward the same factors, such as growth stocks or large caps. The checks you do at the fund level should feed into a broader review of your entire portfolio. Revisit the checklist every year or when you rebalance. Markets shift, fund managers change, and expense ratios can creep up. A disciplined approach to selection and monitoring is what turns a collection of ETFs into a genuinely diversified portfolio.